

Message Text

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ACTION EB-04

INFO OCT-01 SS-04 ADP-00 NSC-04 NSCE-00 TRSE-00 FRB-03

INR-01 CIEP-01 RSR-01 RSC-01 /020 W

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R 091530 Z MAY 73

FM AMEMBASSY PARIS

TO SECSTATE WASHDC 9917

C O N F I D E N T I A L SECTION 1 OF 2 PARIS 12675

LIMDIS GREENBACK

E. O. 11652: GDS

TAGS: EFIN, IMF

SUBJECT: MEETING OF TECHNICAL GROUP OF C-20 ON DISEQUILIBRATING
CAPITAL FLOWS, MAY 2-4 (PART 2 OF 2 PARTS)

REF: PARIS 12575

PASS TREASURY FOR DEPUTY UNDER SECRETARY BENNETT AND FEDERAL
RESERVE FOR BRYANT

ITALIAN REPRESENTATIVE SAID ITALIAN DUAL RATE SYSTEM WAS
COMPLEX LIKE FRENCH RATHER THAN SIMPLE LIKE BELGIAN. ITALIANS
RELY HEAVILY ON COMPENSATORY FINANCING IN TWO FORMS. BANKS KEEP
A BALANCED SPOT AND FORWARD POSITION UNLESS AUTHORITIES DECIDE
OTHER WISE AND COVER BANKS AGAINST EXCHANGE RISK THROUGH
ISTCAMBI. PARA- STATAL ENTITIES MAY BE REQUIRED TO BORROW
ABROAD AND THE ENTITIES ASSUME THE EXCHANGE RISK. LATTER BOR-
ROWING WAS \$1 BILLION IN 1972. TIMING OF COMMERCIAL PAYMENTS
HAD BEEN REDUCED BY REGULATION TO WITHIN ONE MONTH OF ACTUAL
SHIPMENT, AND THIS SEEMED TO BE WORKING WELL.

NETHERLANDS REPRESENTATIVE SAID BORROWING ABROAD HAD BEEN
RESTRICTED SINCE 1965. BANKS WERE NOT ALLOWED TO HAVE A NEGATIVE
NET POSITION. SINCE 1965 THEY HAD BEEN CONSTANTLY PLUGGING NEW
LOOPHOLES. HAD TO BREAK COMMITMENTS UNDER OECD LIBERALIZATION
CODES TO RESTRICT TRADE BORROWING ABROAD. NEGATIVE INTEREST
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RATE SEEMS TO BE REDUCING NON- RESIDENT GUILDER ACCOUNTS. TIGHTEN-
ING OF DUTCH CONTROLS PUTS BURDENS ON COMPETITIVE POSITION OF
DUTCH BANKS AND TRADERS -- THIS PLACES LIMITS ON HOW FAR ONE
COUNTRY CAN GO UNLESS BURDENS ON BANKS AND TRADERS ARE HARMONIZED.

MUELLER ENDERS (GERMANY) SAID GERMAN MEASURES OVERLAP SOME, BUT TEMPORARY FLOATING IS PERHAPS THE ONLY EFFECTIVE MEASURE IN A CRISIS. ADMINISTRATIVE LICENSES ARE REQUIRED FOR ABNORMAL TRADE CREDITS, WHICH ARE ALSO SUBJECT TO THE BARDEPOT, AS WELL AS CERTAIN SECURITY PURCHASES BY FOREIGNERS. RIEKE SAID BUNDESBANK SIMPLY GRANTS NO REPEAT NO LICENSES ON BORROWING OR SECURITY PURCHASES TO AVOID ADMINISTRATIVE PROBLEMS. BUNDESBANK FEELS MORE CONFIDENT THAN BEFORE THAT IT CAN OFFSET INFLOWS, THOUGH WOULD PREFER TO KEEP OUT FOREIGN FUNDS. JAPANESE REPRESENTATIVE COMMENTED THAT GERMAN CONTROL SYSTEM APPEARED TO HAVE FAILED IN CRISIS. GERMAN REPRESENTATIVE AGREED BUT SAID DM ESPECIALLY SUBJECT TO SPECULATION AND CITED LEADS AND LAGS, WHERE SHIFT OF 2 WEEKS IN PAYMENT TERMS COULD BRING IN 20 BILLION DM. SAID GERMANY WAS CONSIDERING WHETHER TO OBTAIN LEGAL AUTHORITY TO CONTROL NET FOREIGN POSITION OF BANKS, BUT THERE WERE MANY VIEWS ON THIS. RIEKE SAID REGULATED NET FOREIGN POSITION OF BANKS WOULD STILL LEAVE PROBLEM OF OTHER INFLOWS THAT WOULD BE IMPORTANT FOR MONETARY POLICY.

CHAIRMAN MORSE SUMMARIZED DISCUSSION SO FAR AS INDICATING THAT CONTROLS ON INTEREST- INDUCED FLOWS NOT EFFECTIVE IN CRISIS PERIODS. MOST CONTROL SYSTEMS NOT PARTICULARLY EFFECTIVE, AND NO DOUBT FLOATING NECESSARY IN SOME SITUATIONS. COUNTRIES HESITATE TO TAKE STRONG MEASURES ON NON- RESIDENTS. PROBLEM OF FLOWS IS LIKELY TO REMAIN AND TO CALL FOR CONSULTATION AND CONCERTATION. THIS WILL BE AN IMPORTANT PART OF INTERNATIONAL CONSULTATION AND SURVEILLANCE. IF ONE COUNTRY SUCCEEDS, THE PRESSURE ON OTHERS GROWS, AND THERE IS ALSO THE DIFFICULTY OF THE COMPETITIVE POSITION OF BANKS IN RESPECTIVE COUNTRIES. A SYSTEM WITH NO CONTRIBUTION FROM U. S. IN MOMENTS OF STRESS WILL BE FUTILE. COULD U. S. MAINTAIN CONTROLS THAT WOULD BE EFFECTIVE IN CRISIS?

SAMMONS (U. S.) NOTED PRELIMINARY DATA FOR MARCH INDICATED OUTFLOW NOT LARGE THROUGH BANKS, WHICH HAD BEEN IMPORTANT CHANNEL IN FEBRUARY. AUTHORITIES HAD DISCUSSED POSSIBILITY OF SHIFTING BANK CONTROLS TO MARKET- ORIENTED FORMS. OFFICIAL DOLLAR DEPOSITS PRESENTED A PROBLEM. U. S. HAD LARGE NUMBER OF BANKS AND CONTROLS
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WOULD BE VERY DIFFICULT TO BRING INTO EFFECT ON STANDBY BASIS. THE THOUGHT OF GENERAL EXCHANGE LICENSING WAS A FRIGHTENING ONE. CHAIRMAN ASKED WHETHER NON- RESIDENT BANKS AND CORPORATIONS SHOULD HAVE UNRESTRICTED RIGHT TO BORROW FROM U. S. BANKS, AS DISTINCT FROM RIGHT TO WITHDRAW THEIR DEPOSITS. RIEKE (GERMANY) NOTED THAT GERMAN REFUSAL TO ACCEPT DM DEPOSITS WOULD PROBABLY DRIVE FUNDS BACK INTO DOLLARS OR STERLING AND ENCOURAGE A REFLUX OF GERMAN FUNDS INTO DM. WILLIS (U. S.) NOTED U. S. PROPOSAL FOR REFORMED SYSTEM PERMITTING ISSUING COUNTRY TO LIMIT FOREIGN OFFICIAL ACQUISITIONS OF ITS CURRENCY. SAMMONS (U. S.) NOTED THAT LEGISLATION MIGHT BE NECESSARY TO AUTHORIZE RESTRICTIONS ON NON- RESIDENT TRANSACTIONS OF NON- MEMBER BANKS AND FOREIGN BRANCHES AND AGENCIES. JAPANESE REPRESENTATIVE SAID U. S. PAPER HAD BEEN VERY HELPFUL IN

EXPLAINING DIFFICULTIES OF APPLYING CONTRO
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ACTION EA-04

INFO OCT-01 SS-04 ADP-00 NSC-04 NSCE-00 TRSE-00 FRB-03

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R 091530 Z MAY 73

FM AMEMBASSY PARIS

TO SECSTATE WASHDC 9918

C O N F I D E N T I A L SECTION 2 OF 2 PARIS 12675

LIMDIS GREENBACK

ENGLAND WOULD PRESUMABLY HOLD REQUIRED RESERVES. FLEMING NOTED THAT IF REQUIRED RESERVES WERE HELD IN U. S., THIS WOULD MEAN AN INFLOW OF CAPITAL INTO UNITED STATES.

DIZ (AGR) ARGUED QUESTION OF PRINCIPLE SHOULD BE DISCUSSED BY DEPUTIES BEFORE WE DISCUSSED MEANS. POINTED OUT WE HAD NOT REPEAT NOT DISCUSSED THE BIS PAPER. SHOULD WE NOT IMPROVE EFFICIENCY OF NATIONAL BANKS RATHER THAN REDUCE EFFICIENCY OF EURO-BANKS. BURDEN OF PROOF SHOULD BE ON THOSE WHO WISH TO TAKE ACTION. CHAIRMAN CITED 3 REASONS FOR RESTRAINT: (A) PROMOTE STABILITY OF INDIVIDUAL CURRENCIES, (B) GENERALLY STABILIZE MONEY SYSTEM, AND (C) EQUALIZE COMPETITIVE POSITION OF NATIONAL BANKS. ETHIOPIAN REPRESENTATIVE SUGGESTED EXCEPTION FOR ALL TRANSACTIONS OF WEAKER COUNTRIES, BOTH AS BORROWERS AND DEPOSITORS. BRAZILIAN ARGUED THAT ONLY ONE COUNTRY (GERMANY) WAS INTERESTED IN RESTRAINTS. OTHERS WERE SATISFIED WITH CONTROLS ON INFLOWS. HOWEVER, NETHERLANDS REPRESENTATIVE SAID COUNTRIES CAN'T PROTECT THEMSELVES UNLESS SOMETHING DONE ABOUT EURO- MARKETS. BRAZILIAN SAID LESS THAN ONE- FIFTH OF EURO- MARKET LOANS WERE TO GOVERNMENTS AND FOUR- FIFTHS FINANCED INDUSTRY AND TRADE THAT SHOULD NOT BE RESTRAINED BECAUSE OF EURO- MARKET PRESSURE ON GERMANY. BRAZIL HAD SPECIAL INTEREST IN BOTH PLACEMENTS AND BORROWING IN EURO-DOLLAR MARKET. SAMMONS (U. S.) REFERRED TO DESIRABILITY OF MORE EQUITABLE COMPETITIVE POSITION OF BANKS TO PROMOTE BEST ALLOCATION OF RESOURCES BUT ADDED THAT RESERVE REQUIREMENTS WOULD NOT STOP GROWTH OF EURO- DOLLARS IF BANKS COULD ATTRACT

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FUNDS ON COMPETITIVE TERMS. CHOI (MALAYSIA) OPPOSED ACTION. TAYLOR (AUSTRALIA) WAS SKEPTICAL OF RESTRAINT BUT SAID REPORT WOULD PROBABLY HAVE TO BE DIVIDED ON POINT. CANADIAN REPRESENTATIVE (DRABBLE) THOUGHT EFFECTS WOULD BE MARGINAL AT BEST AND

BANKING OPERATIONS LIKELY TO MOVE ELSEWHERE IF MEASURES WERE REALLY PUNITIVE. CANADIAN REPRESENTATIVE (NEUFELDT) SAID REAL CULPRIT WAS NOT EURO- MARKET BUT INEFFECTIVE ADJUSTMENT PROCESS. AUSTRALIAN SUGGESTED SPECIAL RESERVE REQUIREMENTS MIGHT BE IMPOSED ONLY AT TIMES OF STRESS. DIZ SUGGESTED RESERVE REQUIREMENTS HAVE NOT STOPPED DOMESTIC INFLATION AND WOULD NOT REPEAT NOT STOP WORLD INFLATION. PERHAPS CENTRAL BANKS SHOULD PAY INTEREST ON DOMESTIC REQUIRED RESERVES. OTHER IDEAS OFFERED WERE TO PROHIBIT INTEREST PAYMENTS ON DEPOSITS OF LESS THAN 30 DAYS OR TO HAVE LOWER RESERVE REQUIREMENTS ON LONGER- TERM DEPOSITS.

CHAIRMAN CONSLUDED THERE WAS FUNDAMENTAL DISAGREEMENT IN GROUP. A FEW COUNTRIES WERE KEEN BUT MAJORITY SKEPTICAL. WIDEST SUPPORT, BUT NOT TOO WIDE, WOULD BE FOR MEASURES TO REDUCE COMPETITIVE EDGE. RESERVE REQUIREMENTS MIGHT POSSIBLY BE APPLIED TO ASSETS WITH AN LDC EXEMPTION OR POSSIBLY TO LIABILITIES WITH HEAVIER REQUIRMENTS ON SHORT- TERM DEPOSITS, THOUGH NOT REPEAT NOT MUCH SUPPORT FOR THIS. GROUP DEBATED WHETHER EURO- MARKET OF U. S. BANKS HAD BEEN MAIN SOURCE OF FINANCING IN FEBRUARY- MARCH CRISIS, WITH TENDENCY TO SAY BORROWING HAD BEEN CHEAPER IN U. S. CHAIRMAN CONCLUDED VERDICT WAS " NOT PROVEN" AS TO EURO- MARKET AS SOURCE OF FINANCING FOR LEADS AND LAGS AND OTHER FLOWS, EXCEPT AS A CHANNEL FOR NATIONAL FINANCING SOURCES.

DIVERSIFICATION OF OFFICIAL FUNDS

CHAIRMAN SAID REFORM OF MONETARY SYSTEM SHOULD COVER NEXT 10-15 YEARS. COULD WE EXPECT OFFICIAL FUNDS TO MOVE BACK AND FORTH? CHAIRMAN THOUGHT SO. CONSIDERABLE SPECTRUM OF VIEWS ON THIS. FACTORS MENTIONED INCLUDED (A) CHANGES IN TRADE PATTERNS, (B) U. S. PAYMENTS DEVELOPMENTS, (C) CHARACTERISTICS OF NEW SDR, (D) ASSET SETTLEMENT SYSTEM AND DEGREE OF COMPULSION LIKELY IN IT, (E) MORE CAPITAL EXPORTERS, (F) FAMILIARITY WITH DIVERSIFICATION (G) MULTIPLE CURRENCY INTERVENTION, (H) SIZE OF MONEY MARKET, (I) CONTROLS AND RESTRICTIONS, (J) NATIONAL ATTITUDES AND POLICIES SUCH AS G-10 SELF- DENYING ORDINANCE, (K) CONSOLIDATION, CONFIDENTIAL

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AND (L) EXTENT OF FLOATING IN FUTURE.

CHAIRMAN CONSLUDED HEART OF MATTER IS WHAT ARRANGEMENTS ARE MADE FOR RESERVE ASSETS. THERE IS NEED FOR A GOOD STORE OF VALUE IN SDR. REGULATIONS WILL PLAY A PART. EURO- MARKETS CAN HAVE STATISTICAL EFFECT ON RESERVES, GIVEN FIXED EXCHANGE RATES AND INTERVENTION WITHOUT CORRESPONDING CONVERSION INTO PRIMARY RESERVE ASSETS. DEVELOPING COUNTRIES APPARENTLY ARE NOT REPEAT NOT INCLINED TO STOP PLACEMENTS IN EURO- MARKET BUT MATTER WILL BE PURSUED IN DEPUTIES. CHAIRMAN ESTIMATED THAT AT END OF 1972 RESERVE HOLDINGS INCLUDED THE FOLLOWING:

(A) FOR G-10 COUNTRIES LESS THAN \$5 BILLION IN NON- TRADITIONAL

FORMS, MAINLY IN EURO- DOLLARS.

(B) FOR NON- G-10, ABOUT 10-15 , BILLION DOLLARS IN EURO- DOLLARS AND PERHAPS 5 BILLION DOLLARS IN CURRENCIES OTHER THAN DOLLARS OR STERLING.

DEVELOPING COUNTRIES REITERATED THEIR OBJECTIONS TO ANY RESTRAINTS ON THE EURO- MARKET WHICH WOULD INCREASE THEIR BORROWING COSTS.

IN RESPONSE TO REQUEST FROM CHAIRMAN AS TO U. S. CONTRIBUTION, SAMMONS (U. S.) SAID U. S. WOULD NOT PRECLUDE REASONABLE ACTION TO CONTRIBUTE. EUROPE WAS AWARE THAT CONSIDERATION WAS BEING GIVEN TO REGULATION M WHICH AFFECTED BANK BORROWING FROM THE EURO- MARKET UNDER SOME CONDITIONS. INDUCED BANK FINANCING OR DIRECT BORROWING FROM EURO- MARKET WHEN INTEREST RATE DIFFERENTIALS DID NOT FAVOR BORROWING PRESENTED SERIOUS PROBLEMS, ESPECIALLY AS LONG- RANGE POLICY. ALSO THERE WAS LIKELIHOOD OF CAROUSEL EFFECT AND ATTRACTION OF OTHER U. S. FUNDS INTO EURO- MARKET IN ABSENCE OF WATER- TIGHT U. S. EXCHANGE CONTROLS.

CHAIRMAN REFERRED BRIEFLY TO IDEA OF INVESTMENT FOR OIL COUNTRIES. VENEZUELAN REPRESENTATIVE SAID U. S. PROPOSAL DESERVED CAREFUL CONSIDERATION AND SHOULD BE DISCUSSED BY DEPUTIES. SAMMONS (U. S.) NOTED THAT THE RETURN ON OFFICIAL ASSETS AND OTHER INVESTMENTS GENERALLY REFLECTS AN INFLATION ELEMENT. IF ASSETS BEAR AN EXCHANGE GUARANTEE THIS SHOULD BE REFLECTED IN THE RATE OF INTEREST AND THIS WOULD APPLY TO FOREIGN EXCHANGE HOLDINGS AND TO SDRS. CONFIDENTIAL

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CHAIRMAN EEXPRESSED CONCURRENCE. JANSON (BELGIUM) RAISED QUESTION OF RECHANNELING OIL COUNTRY FUNDS, E. G., THROUGH IDA, TO NEEDY DEVELOPING COUNTRIES. CHAIRMAN NOTED THIS AS AN IMPORTANT POINT.

FINANCING AND OFFSETTING

RIEKE (GERMANY) SAID IT WAS HARD TO RESTRICT BANKS IN ORDER TO OFFSET FOREIGN BORROWING BY NON- BANKS. RECENTLY THERE HAD BEEN SEVERE CREDIT CRUNCH IN GERMANY AND HE HAD BECOME SOMEWHAT MORE OPTIMISTIC AS TO ABILITY TO OFFSET WITH SOME LAG. FLOATING RATE MAKES IT EASIER TO OFFSET, AND ALL EFFORTS TO OFFSET WITH FIXED RATE WERE COUNTER- PRODUCTIVE. NETHERLANDS AGREED IMPOSSIBLE TO OFFSET WITH FIXED RATE AND MUST LET INTEREST RATES FALL TO STOP INFLOW. U. K. REPRESENTATIVE SUSPECTED OFFSET MAY DIRVE INFLOW INTO LEADS AND LAGS. SAMMONS (U. S.) INQUIRED AS TO FEASIBILITY OF HIGH MARGINAL RESERVE REQUIREMENTS ON TOTAL DEPOSITS -- DOMESTIC AND FOREIGN. RIEKE SAID IN A BIG CRISIS EVERY CHANNEL FILS UP. CANADIAN REPRESENTATIVE DISAGREED WITH IMF REPRESENTATIVE AND SAID OFFSETTING IS NOT REPEAT NOT FEASIBLE WITHOUT FLOATING RATE, AND THIS WAS A REASON FOR CANADIAN FLOAT IN 1970.

CHAIRMAN INDICATED NOT REPEAT NOT TIME TO DISCUSS FINANCING
UNTIL NEXT WEEK. ITALIAN REPRESENTATIVE SAID OSSOLA WOULD WEL-
COME COMMENTS ON ITALIAN PAPER ON THIS SUBJECT. SAID CONCEPT
OF A MONETARY AREA IS VERY LOOSE. THE EC IS THE ONLY CLEAR
EXAMPLE, BUT A LATIN AMERICAN SETTLEMENT ARRANGEMENT WOULD PROB-
ABLY FIT INTO THE ITALIAN SCHEME.

IRWIN

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